(33)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

ROBERT W. JOHNSTON, *Petitioner,* *vs.* COMMISSIONER OF INTERNAL REVENUE.	No. 1080
T. ALICE KLAGES, *Petitioner,* *vs.* COMMISSIONER OF INTERNAL REVENUE.	No. 1081

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

ROBERT W. JOHNSTON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. .....

T. ALICE KLAGES,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. .....

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The petitioners respectfully pray that writs of certiorari issue to review the judgments of the United States Circuit Court of Appeals for the Second Circuit entered in the above-entitled causes on March 10, 1944 affirming orders of the Tax Court of the United States entered February 10 and February 13, 1943, respectively, determining a deficiency in each petitioner's federal tax liability for the calendar year 1937 in the amount of approximately $15,600.

Opinions Below.

The opinion of the United States Circuit Court of Appeals in both cases is reported in 141 F. (2d) 208 (J 59; K 55).* The opinion of the Tax Court in both cases is reported in 1 T. C. 228 (J 19; K 15).

Jurisdiction.

The statutory provisions believed to sustain the jurisdiction of this Court are Sec. 1141 of the Internal Revenue Code and Sec. 240(a) of the Judicial Code as amended (28 U. S. C. Sec. 347).

Question Presented.

The question is the same in both cases. It is whether, after the sale by trustees, at a loss, of improved real estate previously acquired through the foreclosure of a bond and mortgage owned by the trust, that portion of the net proceeds of the sale to which the petitioners, the income beneficiaries of the trust, became entitled under the applicable rule of law of the State of New York, was income, taxable to the petitioners under the provisions of the Revenue Act of 1936 and of the Sixteenth Amendment to the Constitution of the United States.

Statutes Involved.

The following are the pertinent sections of the Revenue Act of 1936:

"SEC. 22. GROSS INCOME.

(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries,

* "J" refers to the Johnston record and "K" to the Klages record; as all material facts and the opinions below are the same in both cases, actual reference is necessary to only one of the records.

wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

"(b) Exclusions from Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this title: * * *

"(3) Gifts, Bequests, and Devises.—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income); * * *

* * * * * *

"SEC. 161. IMPOSITION OF TAX.

(a) Application of Tax.—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including——

* * * * * *

"(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

* * * * * *

"(b) Computation and Payment.—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, * * *"

"SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that——

* * * * * *

"(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, * * * but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *"

Statement.

These two cases present exactly the same question which arises out of identically the same facts. Any decision with respect to one must necessarily control the other and presentation of two petitions in separate form would be repetitious and not in the interests of brevity.

The petitioners were the income beneficiaries of two trusts created by a single deed of trust and administered by the same trustees (J 23; K 19).

On default in interest payments the trustees foreclosed a bond and mortgage owned by the trusts and at the foreclosure sale in December, 1932, bid in the mortgaged premises for the trusts for $600,000, the amount of unpaid principal (J 25; K 21).

On January 11, 1937 the trustees sold the property so acquired for $550,000, receiving $100,000 in cash and a purchase money bond and mortgage in the principal amount of $450,000 (J 26; K 22). This sale concededly resulted in a loss to each trust which was reported on the fiduciary income tax returns filed by the trustees (J 27; K 23).

The trustees in 1937 apportioned the net sale proceeds, including the bond and mortgage at par, between the income beneficiaries and trust principal in the ratio which the amount of unpaid interest on the foreclosed mortgage

(computed at the stipulated mortgage rate from date of last payment to the date of sale) bore to the amount of unpaid principal. Accordingly, approximately 21% of the sale proceeds was allocated to the petitioners; in each case this amounted to about $57,600 (J 27-28; K 23-24). This apportionment was pursuant to the rule* established by the New York courts in *Matter of Chapal*, 269 N. Y. 464, 199 N. E. 762, and *Matter of Otis*, 276 N. Y. 101; 11 N. E. 2(d) 556 (J 29; K 25).

For the purposes of these applications, said amounts, as in the court below, are treated as having been paid or credited in 1937 to each petitioner out of the sale proceeds.

The respondent included these allocated amounts in the 1937 taxable income of each of the petitioners (J 21; K 17), which action gave rise to the tax deficiencies here in controversy.

Rulings of the Courts Below.

The Tax Court of the United States, on appeals by both petitioners, sustained the respondent (three judges dissenting), and held that the amounts were taxable income under Sec. 162(b) of the Revenue Act of 1936, but if not under that section, then taxable under Sec. 22(a) (J 41; K 37).

Both petitioners sought review by the Circuit Court of Appeals for the Second Circuit. That court unanimously affirmed the orders of the Tax Court (J 66; K 62).

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* This rule as affected by later legislation was before this Court in *Demorest, Jr.* vs. *City Bank Farmers Trust Co., et al.*, ... U. S. ....; 64 S. Ct. 384.

Assignments of Error.

1. The Circuit Court erred in holding that the portion of the sale proceeds to which the petitioners became entitled was taxable income to the petitioners.

2. The Circuit Court erred by giving controlling effect to a local rule of law in New York as against federal law in the determination of whether the amounts in question were taxable income.

3. The Circuit Court erred in affirming the orders of the Tax Court.

Reasons for Granting the Writs.

1. The decision of the Circuit Court involves the fundamental concept of what is to be regarded as income for federal tax purposes, particularly in connection with trust estates. Under the decision, although the sale proceeds represented a loss to the trusts, and although under Section 162(b) the petitioners were taxable only on trust income currently distributable to them, nevertheless the petitioners' share of those proceeds, acquired under a local rule of law, was held to be taxable income to them.

The decision also involves the question of the effect to be given to the local rule of law in the determination of what is income under federal tax law.

In at least six states other than New York similar apportionment rules are applied in so-called salvage operations, which, due to many mortgage defaults, have been and will be of frequent occurrence in the administration of numerous trust estates.*

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* Massachusetts, Maine, Rhode Island, New Jersey, Tennessee and Pennsylvania (Citations, note (1), p. 11 of brief). Inquiries to several large trust companies in New York City alone indicate thousands of trusts in their charge which are or will be affected by the decision in these cases.

Whether the amounts allocated to the petitioners can be regarded as taxable income under Sections 162(b) or 22(a) of the Revenue Act, or, indeed, under the Sixteenth Amendment to the Constitution of the United States, is, therefore, an important question of federal law which has not been, but should be, settled by this Court.

2. In these cases the trusts had no income; the apportioned proceeds were realized on a sale at a loss to the trusts (J 27; K 23). If the Circuit Court regarded the sale proceeds as "income" to the extent of the petitioners' share therein, its decision probably conflicts with the concept of "income" expressed by this Court in *Eisner* v. *Macomber*, 252 U. S. 189, 206, 207; 40 S. Ct. 189.

What was allocated to the petitioners was a part of trust principal, and it retained its non-taxable character in their hands. The decision in this respect conflicts with *Helvering* v. *Falk*, 291 U. S. 183; 54 S. Ct. 353.

Because the petitioners received something from the trusts, it does not follow that what they received was trust income, or income to them even if not trust income. In this respect it is difficult to reconcile the decision in principle with *Burnet* v. *Whitehouse*, 283 U. S. 148; 51 S. Ct. 374, and *Helvering* v. *Butterworth*, 290 U. S. 365; 54 S. Ct. 221.

Principles of federal law control in the determination of whether the amounts here involved were income under the Revenue Act and the Sixteenth Amendment, regardless of how the New York Courts may choose to treat them for equitable purposes. In purporting to follow the local rule and decisions which have no counterpart in federal tax law, the Circuit Court erred. *Lyeth* v. *Hoey*, 305 U. S. 188, 193; 59 S. Ct. 155; *Burnet* v. *Harmel*, 287 U. S. 103, 110; 53 S. Ct. 74.

The Circuit Court, therefore, has decided a federal question in a way probably in conflict with applicable decisions of this Court.

3. The Circuit Court's decision probably conflicts with the decisions of local courts. It erroneously assumed that the Chapal-Otis rule constituted the petitioners "lienors upon the land" to the extent of the unpaid interest on the foreclosed mortgage (J 65; K 61) and, apparently, that the sale proceeds were regarded as trust income to the extent of the petitioners' share therein (J 64; K 60). The decisions of the local courts, however, negative the correctness of such assumptions. *Martin's Estate*, 165 Misc. 597, 609-610, 1 N. Y. S. (2d) 80; *In re Renn's Will*, 42 N. Y. S. (2d) 400 (Surrogates Court; not officially reported).

For the above reasons, it is respectfully submitted that a writ of certiorari should issue in each of these cases.

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BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

Opinions Below.

As these cases are the same in every material respect, involving the same question and identical facts, they were argued and decided together in the courts below. The opinion of the Circuit Court of Appeals is reported in 141 F. (2d) 208 (J 59; K 55).* The opinion of the Tax Court of the United States is reported in 1 T. C. 228 (J 19; K 15).

Jurisdiction.

The statutory provisions believed to sustain jurisdiction of this Court are Sec. 1141 of the Internal Revenue Code and Sec. 240(a) of the Judicial Code as amended (28 U. S. C. 347). The judgments of the Circuit Court of Appeals sought to be reviewed were entered March 10, 1944 (J 66; K 62).

Question Presented.

The question is the same in both cases. It is whether, after the sale by trustees, at a loss, of improved real estate previously acquired through foreclosure of a bond and mortgage owned by the trust, that portion of the net proceeds of the sale to which the petitioners, the income beneficiaries of the trust, became entitled under the applicable rule of law of the State of New York, was income, taxable to the petitioners under the provisions of the Revenue Act

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* "J" refers to the Johnston record and "K" to the Klages record; as all material facts and the opinions below are the same, actual reference is necessary to only one record.

of 1936 and of the Sixteenth Amendment to the Constitution of the United States.

The applicable rule of law referred to is set forth in the opinions of the Court of Appeals of New York in *Matter of Chapal*, 269 N. Y. 464, 199 N. E. 762; and *Matter of Otis*, 276 N. Y. 101, 11 N. E. (2) 556.

Statutes Involved.

The statutes involved are Sections 161, 162 and 22(a) and (b) of the Revenue Act of 1936 which, in so far as pertinent, are set forth in the petition at pages 2, 3, and 4.

Facts.

The facts, which are the same in both cases, are set forth under the heading "Statement" at page 4 of the petition and are not repeated here in the interest of brevity.

ARGUMENT.

I.

An important question of Federal law is presented.

The precise question here presented has not been decided heretofore by this Court nor by any other court except those below in these two cases.

If an individual had owned and foreclosed the bond and mortgage and thereafter sold the real estate taken in foreclosure at a loss, as did the trustees here, clearly no taxable income would have resulted. The novel effect of the Circuit Court's decision, therefore, is to create taxable income through division of the sale proceeds between bene-

ficiary and remainderman where, if the interests had been combined, there would have been no income.

The decision does violence to the entire scheme of taxation set forth in Sections 161 and 162 of the Revenue Act. These sections contemplate that before amounts shall be income to the beneficiaries they must first be trust income and deductible by the trust. Here, in fact, the trustees had no income and so no income could have been distributed to petitioners.

In addition to the New York rule and those in other states[1] applicable in so-called "salvage operations", there is the further rule, followed in New York and elsewhere,[2] requiring apportionment of the proceeds on a sale by a trustee of originally unproductive real estate, which it is submitted also is affected by the decision herein.

The abolition of the Chapal-Otis rule in 1940 (L. 1940, ch. 452; eff. Apr. 13, 1940) does not detract from the importance of the question as such abolition does not affect trust estates in existence and having mortgage investments on the date of the enactment of the statute.

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[1] *Hudson County National Bank* v. *Woodruff*, 122 N. J. Eq. 444, 194 Atl. 266 (1937); *Veazie* v. *Forsaith*, 76 Me. 172 (1884); *Springfield Safe Deposit & Trust Co.* v. *Wade*, 305 Mass. 36; 24 N. E. (2d) 764 (1940); *Nirdlinger's Estate* (No. 2) 327 Pa. 171, 193 Atl. 30 (1937); *Greene* v. *Greene*, 19 R. I. 619, 35 Atl. 1042 (1896); *Quinn* v. *First National Bank*, 168 Tenn. 30, 73 S. W. (2d) 692 (1934).

[2] *Scott on Trusts* (1939) Secs. 240, 241, Vol. 2; *Lawrence* v. *Littlefield*, 215 N. Y. 561, 109 N. E. 611; *Jordan* v. *Jordan*, 192 Mass. 337, 78 N. E. 459; *Martin* v. *Kimball*, 86 N. J. Eq. 10, aff'd, p. 432, 96 Atl. 565.

II.

The Circuit Court's decision probably conflicts with applicable decisions of this Court.

The petitioners contended below and contend here that these cases must be judged in the light of controlling federal law; that, so viewed, all that occurred was a sale by the trusts of real estate acquired in foreclosure, resulting in a loss to the trusts so that the proceeds were only trust principal (and not trust income), a part of which was then allocated to the petitioners under the Chapal-Otis rule; and that, being trust principal, it was not income to them taxable under Section 162(b) of the Revenue Act as currently distributable trust income.

The effect of the Chapal-Otis rule, it is contended, is to treat the situation as if the creator of the trusts had specifically directed the apportionment of the sale proceeds, the result being analogous to a bequest or gift in the form of an annuity created by will or trust which is payable out of principal if income is insufficient, that is, it is payable in any event, and so is expressly exempted from income tax under Section 22(b) (3). *Burnet* v. *Whitehouse*, 283 U. S. 148; 51 S. Ct. 374. *Helvering* v. *Butterworth*, 290 U. S. 365, 374; 54 S. Ct. 221.

If, however, the Circuit Court did regard the petitioners' share as being trust income, the concept of "income" inherent in its decision, it is submitted, is in conflict with the definition that income is "the gain derived from capital, from labor, or from both combined * * *," and that what is or is not "income" under the Sixteenth Amendment must be determined according to truth and substance without regard to form. *Eisner* v. *Macomber*, 252 U. S. 189, 206, 207; 40 S. Ct. 189.

Here, the trusts recovered, on the sale, less than their original investment in the bond and mortgage (J 25; K 21) and less than their "cost basis" of the real estate for tax purposes; no interest on the defaulted mortgage, computed either to the foreclosure sale in 1932 or, under the Chapal-Otis rule, to the subsequent sale in 1937, was ever, in fact, collected by them (J 27; K 23). In reality, the sale proceeds were not trust income in any form or to any extent and resort to fiction is necessary to find trust income.

If the sale proceeds were not trust income, it follows that they were entirely trust principal, and petitioners' share therein was a distribution of trust principal. In such case that share retained the same character, for tax purposes, in the hands of the petitioners that it possessed in the hands of the fiduciary.

In *Helvering* v. *Falk*, 291 U. S. 183; 54 S. Ct. 353, this Court, in holding a beneficiary entitled to a depletion deduction on mining royalties received from a trust, said that the depletion allowance was a return of capital assets which was left untaxed under the Act and which "remained so in the hands of the beneficiaries." In *Eisner* v. *Macomber*, *supra*, true stock dividends were held not to be "income." And so, under a Treasury ruling of long standing, they are not taxable income when distributed to a beneficiary under state law or pursuant to the trust instrument (I. T. 1622; C. B. II-1, 135).* The decision of the Circuit Court, it is submitted, cannot be reconciled with the foregoing principle and decision of this Court.

In determining what is or is not taxable income, federal law and decisions, and not local laws, are controlling.

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* Similarly: Exempt bond interest; Art. 22(b) (4)-5; Regs. 94; I. T. 2067, C. B. III-2, p. 78; distributable capital gains, I. T. 3495; C. B. 1941-2, p. 195.

Lyeth v. *Hoey*, 305 U. S. 188, 193; 59 S. Ct. 155; *Burnet* v. *Harmel*, 287 U. S. 103, 110; 53 S. Ct. 74.

The Chapal-Otis rule merely established the rights of interested parties in and to a particular item of trust principal; neither the rule itself, the equitable reasons underlying it, nor the fictions employed in its exposition can, or serve to, create taxable income, any more than if the trust instrument itself had, in the absence of the state rule, specifically provided for the same apportionment. The Circuit Court's opinion, it is submitted, indicates that the Court, in arriving at its conclusion, relied entirely on its construction of the peculiarities and special incidences of the local rule, contrary to the principle of the *Lyeth* and *Harmel* cases, *supra*.

III.

The Circuit Court's decision probably conflicts with applicable decisions of the local courts.

The nature of the rights acquired by the petitioners under the Chapal-Otis rule is set forth with particular clarity in *Martin's Estate*, 165 Misc. 597, where the question was as to the right of a trustee to extend and consolidate, without the consents of life tenants and remaindermen, certain purchase money mortgages which were (as in the cases at bar) a part of the proceeds of a sale of property acquired by a trust in foreclosure. In holding such consents unnecessary the court said (pp. 609-610):

> "The *res*, i.e., the salvage proceeds, is at all times owned wholly and exclusively by the fiduciary. There is no tangible property interest in the *res* as such inuring to the income beneficiary or to the remainderman. What each of these persons has is

> only the right (exercised in an accounting or other appropriate proceeding) to have the fiduciary properly allocate the money or property in his hands. That right in an appropriate case may be assignable, but it does not rise to the status of a title to the *res* or to any portion of it. That title is in the fiduciary with all the attendant rights of management."

The rights of the petitioners, therefore, with respect to the real estate itself or to the proceeds realized on its sale, were certainly not those of a lienor as the Circuit Court stated (J 65; K 61).

The Circuit Court apparently regarded the sale proceeds as representing *pro tanto* a recovery of interest, and so income, to which the petitioners were entitled. If that were so, then, under Section 15 of the Personal Property Law of New York, the petitioners' right to such "income" would not be assignable. Yet the New York courts have held that the right is assignable, thus negativing any contention that it was a right to trust income. *In re Renn's Will*, 42 N. Y. S. (2d) 400, 403; (Surrogates Court; not officially reported); *Martin's Estate, supra*, p. 609.

For the reasons set forth, it is respectfully prayed that this Court issue a writ of certiorari in each of the cases at bar.

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JUN 29 1944

Nos. 129 and 130

In the Supreme Court of the United States

October Term, 1944

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ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 129

ROBERT W. JOHNSTON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 130

T. ALICE KLAGES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 19–44) [1] is reported in 1 T. C. 228. The opinion of the Circuit Court of Appeals (R. 59–65) is reported in 141 F. 2d 208.

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[1] All record references will be to the *Johnston* case unless specifically designated otherwise.

JURISDICTION

The judgment of the Circuit Court of Appeals in the *Johnston* case was entered on March 10, 1944 (R. 66). The judgment in the Circuit Court of Appeals in the *Klages* case was entered on March 10, 1944 (Klages, R. 62). The petition for writs of certiorari was filed on June 5, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Both taxpayers were income beneficiaries of a trust created by their mother. Part of the corpus of the trust consisted of a mortgage which the trustees foreclosed, and later bid in. In the taxable year the trustees sold the property at a loss. But in accordance with the law of New York the trustees allocated to the taxpayers as income beneficiaries a portion of the proceeds of the sale in lieu of the income they would have received in the way of interest if no default had occurred. The question presented is as follows:

Whether the portion of the proceeds of sale allocated to the taxpayers by the trustees during the taxable year constitutes income under Section 162 (b) or Section 22 (a) of the Revenue Act of 1936, or under the Sixteenth Amendment.

STATUTE PRESENTED

The statute involved is set forth in the Appendix, *infra*, p. 8.

STATEMENT

The facts as stipulated (R. 1, 31) and as found by the Tax Court (R. 22–31) may be summarized as follows:

Both taxpayers were life beneficiaries under a trust created in 1921 by their mother, under which they were entitled to "the net income" during their respective lives. The corpus of the trust consisted of real estate located in the City of New York. (R. 23–24.)

In 1924, the trustees sold this property and in part payment took back a bond in the principal sum of $600,000, secured upon the property sold. In 1932, the mortgagor defaulted in the payment of interest upon this mortgage and the trustees foreclosed, bidding in the property in December of that year for $600,000. There were then due upon the bond for principal and interest about $628,500,[2] and the expense of foreclosure and unpaid taxes came to about $27,000 in addition. (R. 25.)

On January 11, 1937, the trustees sold the property so bid in for $550,000—$100,000 in cash and $450,000 in a purchase money mortgage (R. 26). The accumulated interest due upon the principal sum of $600,000 from February 1, 1932, to the date of sale by the trustees on January 11, 1937, was about $163,000; so that that part of

[2] $600,000 principal and interest at the rate of 5½ percent from February 1, 1932, until December 13, 1932 (R. 25).

the purchase price of $550,000 to which the life tenants were entitled, if the purchase price were to be divided proportionately between principal and accrued interest, was a little over 21 percent (R. 27). The trustees divided the cash received in that proportion, each beneficiary receiving his or her share in 1937. They also credited the same proportion of the mortgage for $450,000 to the two beneficiaries. Three payments in reduction of the principal of the mortgage which were made in 1937, were also divided in the same manner and the proper share was turned over to each beneficiary. (R. 28–29.)

In their fiduciary return the trustees did not treat any part of these payments as income of either the trusts or the taxpayers, nor did the taxpayers themselves in their individual returns include them in their gross income (R. 20–21, 30–31). The Commissioner sent each of them a deficiency notice upon the ground that the cash which they received and the value of that portion of the mortgage which had been credited to them should be included in their gross income, because it was distributable to them under the trust created by their mother (R. 13–16). In their appeal to the Tax Court the taxpayers contended that since $550,000 was less than the bid upon which the trustees had bought in the property at the foreclosure in 1932, it was impossible to say that they had received income of any kind; that

the payments actually made or credited to them came out of proceeds of the sale of principal, and even though the law of New York allotted a part of those proceeds to them as an equivalent of the interest which they would have received if the original mortgage had still remained in existence, that could not make income out of what was not in fact income. The Tax Court decided that under two decisions of the Court of Appeals of New York,[3] according to which 21 per cent of the proceeds of sale was paid or credited to each taxpayer, the amounts so paid or credited to each taxpayer constituted income. One judge dissented and two others dissented in part. Appeals were taken to the Circuit Court of Appeals, which affirmed the decision of the Tax Court.

ARGUMENT

The findings show that the amounts involved were distributable, under local law, to the taxpayers under the will of their mother, which provided that they were entitled to "the net income" of the trusts during their respective lives (R. 23–24). Thus taxpayers were entitled only to income and received the distributions only because of their status as income beneficiaries. The result here is therefore consistent with *Burnet* v. *Whitehouse,* 283 U. S. 148; *Helvering* v. *Butterworth,* 290 U. S. 365; and *Lyeth* v. *Hoey,* 305 U. S. 188, which plainly hold that the capacity in which the

[3] *In re Chapal*, 269 N. Y. 464, and *In re Otis*, 276 N. Y. 101.

recipient stands with respect to a trust or estate, is determinative.

Section 162 (b) of the Revenue Act of 1936 (Appendix, *infra*) expressly provides that trust income which is to be distributed currently to the beneficiaries shall be included in computing the net income of the beneficiaries. Since the taxpayers were income beneficiaries and the amounts in question were distributed to them in accordance with the terms of the trust, the amount should be included in computing their net income. If, for any reason, Section 162 (b) does not apply, Section 22 (a) of the same Act (Appendix, *infra*), which defines gross income as including income derived from any source whatever, would seem to cover the amounts received by the taxpayers during the taxable year.

The theory upon which the trustees made the distributions was that a pro rata percentage of the receipts was to be regarded as in lieu of income. Therefore, the result is also consistent with the principle that receipts in lieu of income may properly be regarded as income. *Hort* v. *Commissioner,* 313 U. S. 28; *Andrews* v. *Commissioner,* 135 F. 2d 314 (C. C. A. 2d), certiorari denied, 320 U. S. 748.

The decision below is also supported by *Plunkett* v. *Commissioner,* 118 F. 2d 644 (C. C. A. 1st), where a life tenant under a testamentary trust was held to be taxable upon an amount

claimed and received as the equivalent of that which would have accrued as income had the trust property been properly invested.

CONCLUSION

There is no conflict of decisions and the petition for certiorari should be denied.

Respectfully submitted.

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JUNE 1944.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * *

(b) There shall be allowed as an additional deduction in computing the net income of the * * * trust the amount of the income of the * * * trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, * * * but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *.

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